

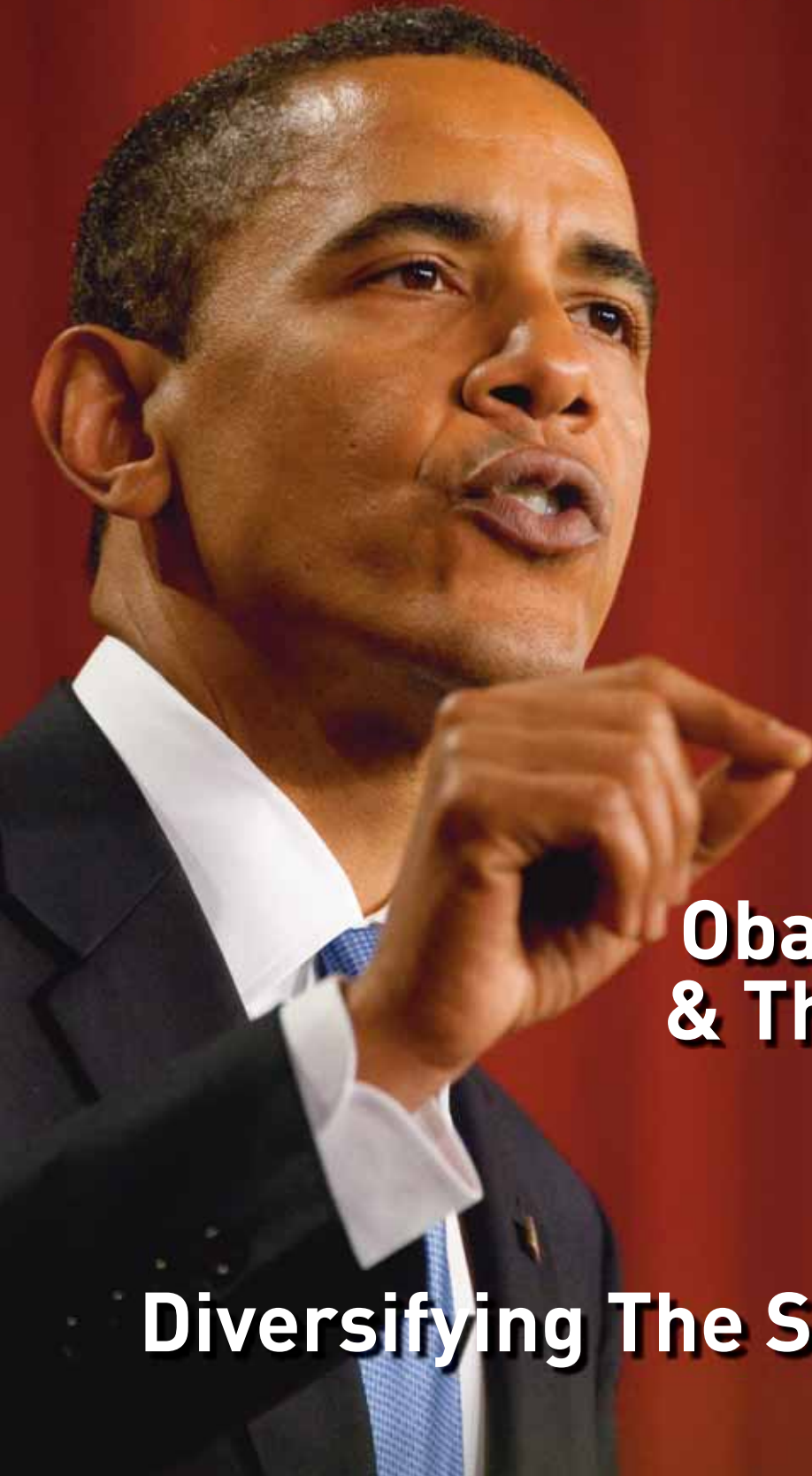
ENERGY & GEOPOLITICAL RISK

Volume 2 No. 6 June 2011

MIDDLE EAST ECONOMIC SURVEY | MEES SINCE 1957 | ALL RIGHTS RESERVED | ©2011 | Published by



The US & The Democratic Spring



**Obama's Doctrine
& The Israeli Knot**

**Natural Gas:
Diversifying The Saudi Economy**



ثِقْ بِهَا، اِعْتَمِدْهَا.



مَصْرَفُ لِبْنَانِ



Publisher :

Dr. Saleh S. Jallad sjallad@mees.com

Editor :

Walid Khadduri walid@mees.com

Editorial Board:

Walid Khadduri walid@mees.com
 Charles Snow charles@mees.com
 Basim Itayim basim@mees.com
 Theodoros Tsakiris ttsakiris@mees.com
 David Knott David@mees.com

Business Development Director:

Rouaida H. el Khazen Rouaida@mees.com

Production Manager :

Shafiq Taher shafiq@mees.com

Finance Manager :

Mohamed Moussa mmoussa@mees.com

Published by:

MEPEP -Middle East Petroleum and Economic Publications.

Contact us:**Cyprus Office**

Middle East Petroleum and Economic Publications
 Office 501 | Politia Business Center
 23 Alkeos Str, 2404 Engomi,
 PO Box 24940, CY-1355 Nicosia, Cyprus
 Tel: (+357) 22 665 431
 Fax: (+357) 22 671 988

Lebanon Office

Middle East Petroleum and Economic Publications
 Hamra, Main Road
 Al Mezan Building, 4th Floor
 Beirut, Lebanon
 Tel: +(961) 1 739328
 Fax: +(961) 1 739327

Website: www.mees.com

email: info@mees.com

For Advertisement: Advertising@mees.com

CONTENTS

Comment	4
Obama's Whirlwind Effect , Gerald Butt	7
The Obama Doctrine And The Israeli Knot, Abd al-Wahab Badrakhhan	13
America And The Democratic Spring, Salama Ahmad Salama	17
Extracts From President Obama's Middle East Policy Speeches, May 2011	20
The Saudi Gas Sector, Bassam Fattouh	22
Oil Market Stability: The 2008 Lessons, Aziz Yahyai and Douglas Linton	27
The Iraqi Economy 2011-2014, Kamal al-Basri	34

COMMENT

US President Barack Obama has failed to relate the Arab Spring to the rights of the Palestinians. In his whirlwind speeches on the Middle East, President Obama dealt with the region in a fragmented way, bowing to the wishes of Israel. But whirlwinds invariably cause damage, and the likelihood is that the Arab-Israeli peace process has been further dented by the storm, according to Gerald Butt, who adds that, more importantly, the speeches failed to inspire optimism among Palestinians, while boosting the domestic support for Israeli Prime Minister Benjamin Netanyahu.

Egyptian author Salama Ahmad Salama reflected general sentiment in the region in his article in the Cairo-daily *al-Shorouk*, as follows: “If Washington is trying to achieve stability in the region by helping emerging democracies in Egypt, Tunisia and elsewhere, then stability in the true sense of the word will not be achieved without the Palestinians being able to obtain their legitimate rights. It is not logical for Obama to speak about the right of the Syrian and Libyan people for freedom while the Palestinians lack the same rights – just because this happens to be Israel’s wish.”

While past Saudi policies have been successful in increasing the importance of natural gas in the domestic mix, they have posed some significant challenges to the current economic development strategy, according to Dr. Bassam Fattouh, who lists the challenges as securing gas supplies to meet the rapid rise in domestic gas demand and reassessing the current gas pricing policy to reflect the rising marginal and opportunity costs of utilizing gas reserves. Dr. Fattouh observes that there are increasing signs that the current strategy based on (i) cheap domestic gas prices (ii) a policy of not exporting or importing gas; and (iii) meeting the rapid growth in

domestic demand through increasing the pace of exploration and exploitation of domestic gas reserves is facing some serious strains. Dr. Fattouh concludes that: “Rather than widening its options to deal with the ‘gas challenge’, Saudi Arabia is likely to continue with its main strategy based on expanding its gas reserves to meet the expected growth in domestic demand.”

Why do markets experience periods of relative stability, followed by periods when oil prices increase to high levels? These and other questions are dealt with by OPEC researchers, Dr. Aziz Yahyai and Douglas Linton. Using the year 2008 as a yardstick for their analysis, they attribute much of volatility in the markets to speculation, which is being more regulated than before. The authors recognize that while volatility cannot be limited, there is widespread agreement that excessive swings are undesirable. They conclude that, “given the location of the major exchanges, efforts to minimize the effects of excessive speculation in the financial oil markets will need to be carried out by the governing and regulatory bodies in consuming countries, and the progress made so far has been encouraging. Indeed, markets have evolved significantly since the last period of regulatory change in the 1970s, and the recent financial crisis has understood the fact that financial regulation and financial innovation need to develop in tandem.”

Dr. Kamal Field al-Basri reviews the options available for Iraqi development during 2011-2014, considering the many constraints that challenge the country at present. He highlights the importance of “joint private-public sector contracts” as a strategic option in the context of Iraq’s development and the difficulties faced by the government in providing basic services.



INSURING THE UAE

Financial strength: A- rating from Standard & Poor's Reaffirmed

Reliability: service excellence for 37 years

Product diversity: a complete range of insurance solutions

Since its inception, Abu Dhabi National Insurance Company (ADNIC) has secured its reputation as a leading provider of quality and affordable insurance products and services. ADNIC is a public shareholding company underpinned by strong capitalization, liquidity and earnings.



OBAMA'S WHIRLWIND EFFECT



In the following three articles we analyse the two Middle East policy speeches given by President Obama in May, and their likely effect on the Arab-Israeli peace process and the Arab Spring. We also examine the reasons for the growing disappointment among Arabs at the Obama administration's handling of Middle East issues.


Gerald Butt*

The effect of President Barack Obama's two key speeches in May on his administration's Middle East policy was like that of a whirlwind: they caused a huge commotion at the time, but were quickly forgotten as the storm moved away. But whirlwinds invariably cause damage, and the likelihood is that the Arab-Israeli peace process has been further dented by the storm.

Above all, the speeches (for extracts, see below) failed to inspire optimism among Palestinians, while boosting the domestic support for Israeli Prime Minister Benjamin Netanyahu.

In the first of the two speeches, at the State Department on 19 May, Mr Obama seemed at first to be offering something new in the shape of a rare public affirmation of the principles at the core of UN Security Council Resolution 242, stating: "the borders of Israel and Palestine should be based on the 1967 lines with mutually agreed swaps, so that secure and recognised borders are established for both states."

* Former Editor-in-Chief of MEES.



We're still growing
and the sky's the limit.

For over 58 years, J.I.C has provided a comprehensive range of insurance products, from motor, marine and property insurance, to liability, life and medical insurance. Over this time, we are still building on our strengths of reliability and trust, so you can rest assured that you are in safe hands.

شركة التأمين الأردنية
Jordan Insurance Company
You can rely on us



Tel: (962) 6 4634161, Fax: (962) 6 4637905, www.jicjo.com

Within a matter of minutes, Mr Netanyahu had dismissed the US president's proposal, saying the 1967 borders were indefensible. He subsequently repeated his objections in talks with Mr Obama in Washington.

Any Palestinian hope that a return to the 1967 lines might, in the US Administration's view, mean an end to settlements and a chance for East Jerusalem to be the capital of an independent state were dashed three days later when President Obama addressed the pro-Israeli lobby group AIPAC. Apparently responding to the fury among American Jews and Israelis themselves, he said (to loud applause) that the land swaps would take account of changes over the past 44 years "including the new demographic realities on the ground" – a clear reference to Jewish settlements.

Mr Netanyahu, in a speech to Congress on Tuesday on 24 May, that was accorded warm applause and a standing ovation, said Israel was prepared to make painful territorial compromises for peace. But he went on to state explicitly that, as far as he was concerned, some Jewish settlements would remain in the West Bank in any peace deal and the future status of Jerusalem as Israel's united capital was not open to negotiations.

“Repackaged Rhetoric”

President Obama's apparent inclination to endorse ultimately at least part of Israel's attitude to settlements and Jerusalem – despite initial signs to the contrary – left Palestinians in despair.

Basim al-Zubaydi, a political science professor from Ramallah, said this meant Washington was "recognising the illegitimate Israeli demographic facts in the 1967 territories. This empties these territories of any political or legal context as stated by international law and UN resolutions. It is clear that the Palestinians will have to fight another battle, now that Obama has clearly stated that he will stand against them."

The American president, in his two speeches, offered little that was new to the Palestinians, denouncing plans to declare unilateral statehood later this year and adding that the reconciliation between Fatah and Hamas posed "an enormous obstacle to peace". Furthermore, he failed to suggest ways of tackling the "two wrenching and emotional issues" of Jerusalem and the fate of Palestinian refugees.

As a Palestinian called Shukri said in a comment posted at the end of an on-line article in al-Quds al-Arabi newspaper: "Obama presented nothing more than repackaged rhetoric. He did not present any light at the end of the tunnel."

By contrast, Mr Netanyahu's forceful public rejection of Mr Obama's initial statement on 1967 borders won broad approval among Israelis. "The wisdom and determination of the prime minister and the dividends that they yielded were evident in President Obama's AIPAC speech," Likud Knesset member Carmel Shama-Hacohen told the daily Haaretz. "President Obama gave an explicit, emphatic 'no' to the '67 lines and Hamas, while expressing boundless support for the State of Israel as a Jewish and a democratic state whose security is ensured."

The quest for peace and security for the Israelis and Palestinians on the basis of a two-state solution was not the sole topic of the Obama speeches. Large parts of both public addresses were devoted to his thoughts on the Arab Spring. Again, some elements were welcomed in Arab countries – the promise of extra financial aid to Egypt and Tunisia, for example. 'Abd al-Wahab Badrakhan, writing in al-Hayat on 26 May (see below), highlighted the US president's announcement that "from now on the interests of his country are in line with those of the Arab people – all of them – in their quest for freedom, the restoration of dignity and the establishment of democracy. Few of Obama's predecessors made pledges of this kind – whether to the people of the Soviet Union or China." But, Mr. Badrakhan continued, while this might constitute the Obama doctrine it certainly was not the doctrine of Congress or the American people. A new president could easily reverse the trend.

Missing The Link

So, ultimately, both speeches left Arabs with a sense of disappointment. But while they may have been critical of his response to the popular revolutions sweeping the region or his failure to offer anything new on the peace process, there was another cause for even more acute dismay: his apparent inability to relate peace efforts to the Arab Spring.

Speaking to the BBC ahead of the State Department speech, Prince Hasan bin Talal of Jordan said he hoped Mr Obama would "look at the region as a region and recognize its interconnectedness. We can't talk about the Arab-Israeli problem, and then the next day talk about Syria, then Bahrain, then Iran, then Yemen and so on. The region is fragmenting."



SOWING TRUST SINCE 1944

MORE THAN 65 YEARS OF SOLID PARTNERSHIP

Since our inception in **1944**, we at **Arabia Insurance** continue to strive in offering our clients unique comprehensive insurance plans and total peace of mind.



You are on solid grounds

Head Office: ARABIA HOUSE BLDG - PHOENICIA STR, P.O. BOX: 11-2172 BEIRUT - LEBANON, TEL: 961-1-363610/1, 961-3-314350 - FAX: 961-1-363659/ 365139
Branches: Beirut Tel: 01-360893/ 360889/ 378873 - Zalka Tel: 01-890828/ 9 - Tripoli Tel: 06-440974 - Saida Tel: 07- 726601 2/3 - Chtaura Tel: 08-545210/ 310

Agency: Ashrafieh Tel: 01-321260 - **Website:** www.arabiainsurance.com
LEBANON - SYRIA - JORDAN - SAUDI ARABIA - UAE - BAHRAIN - QATAR - SULTANATE of OMAN - KUWAIT



But this is precisely the way the US president covered the various issues in his speeches. This outlook, furthermore, is reflected in the widely differing attitudes that Washington is adopting to those Arab states experiencing popular unrest. The double standards on display in this context are reminiscent of those to be found in the US's handling of the Arab-Israeli dispute. As Salama Ahmad Salama wrote in the Egyptian daily, *al-Shorouk* on 23 May (see below), Washington may be trying to achieve stability in the region by helping emerging democracies in Egypt, Tunisia and elsewhere. But stability "in the true sense of the word will not be achieved without the Palestinians being able to obtain their legitimate rights. It is not logical for Obama to speak about the right of the Syrian and Libyan people for freedom while the Palestinians lack the same rights – just because this happens to be Israel's wish."

When Mr Obama was elected president, Arabs were optimistic that real change was at hand, that pressure would be brought to bear both on Israel and despotic regimes in the Middle East. His speech at Cairo University two years ago increased that optimism. So much greater, therefore, is the disappointment at his failure to turn words into action. Now, with his administration unable or unwilling to recognize the "interconnectedness" of the region, disappointment is turning to pessimism. As Mr Badrakhan concludes, the much heralded State Department speech did not go far enough to "deal seriously with the changes in the Arab world or to prove that America has undertaken 'reform' of the mentality that shapes its policies in the region."

Significantly, since the Obama speeches and the virulently negative Israeli response to them, talk of a renewed peace process have evaporated. Far from encouraging that process, the US president has shown clearly how his administration is as unwilling as any previous one to adopt the policies that will help to achieve stability across the Middle East.

This accounts precisely for the whirlwind effect of the Obama speeches: here today, gone tomorrow.

THE “OBAMA DOCTRINE” AND THE ISRAELI KNOT

Abd al-Wahab Badrakhan*



(Extracts from an article published in al-Hayat, 26 May 2011 – MEES translation)

The way that the US administration has dealt with the changes in the Arab world is not brilliant, but it's not bad either. This middle position has been enough to ensure that Obama is entitled to a foreign policy “doctrine” that bears his name. He did not take the initiative to depose or change a regime or leader, but merely interacted with the popular uprisings and revolutions, especially those led by young people. But he stopped short of supporting this president or that by holding them back from the abyss. Indeed, he helped their opponents push them off the edge. And we are talking here about presidents and regimes devoted to the service of the United States.

Obama's speech was intended to pin down this “doctrine” and put it on record. And there can be no doubt that it was an important initiative for Obama to announce that from now on the interests of his country are in line with those of the Arab people – all of them – in their quest for freedom, the restoration of dignity and the establishment of democracy. Few of Obama's predecessors made pledges of this kind – whether to the people of the Soviet Union or China. Instead they put restrictions on trade or on military or security agreements as a means of promoting the rights of the people. But this trade-off between ‘principles’ and ‘business’ is always a source of controversy. The Obama doctrine outlined in the speech could mean that the testing of a new policy has begun. But it certainly does not mean that the US is bound by it. For any future president could reverse it and take a completely different course, for the country does not have rigid principles and ethics. If the world – and especially the Arab world – accepts that this is the Obama doctrine, what about Congress? Does it have a doctrine? And to what extent do American voters care about – or

CCM GROUP

30 years experience

- Medical Publishing & CME Programmes
- Healthcare Communication
- Consultancy
 - Human Resources
(Recruitment, Executive Search and Development)
 - Training





rather not care about – what their president says? In the same way, Arabs are accustomed to believing that the fine words of the president are directed at whoever may want to believe them around the world.

To be fair, in acknowledging what young Arabs have suffered and are suffering in their revolutions, Obama has become emotionally involved in the uprisings. But those taking part in the revolutions do not distinguish between their freedom, dignity and yearning for democracy and their desire to see the Palestinians freed from the yoke of occupation and the despotism associated with it. The protesters and all others do not want war, but they certainly do not accept either the immunity that Israelis enjoy from being punished for their crimes. Neither do they accept the way the US always makes an exception for Israel. They cannot envisage permanent security in the Middle East as long as there is a state that does not accept borders and does not respect any security other than its own. It is likely that Obama, who has decided that US interests have become consistent with those of the Arab people, failed to convince the young revolutionary Arabs when he chose to make a political and official distinction against the interests of the Palestinians and in favor of those of Israel.

Obama acknowledged that the watchwords for the revolutions in the Arab world were “breaking the fear barrier”. But what benefit is there in maintaining and insisting on the continued presence of the barriers of fear and of state terrorism directed at the Arabs? There is, without a shadow of doubt, a “knot” in the American political mind. It was this knot that made Obama cover his veiled criticism of Israel with lavish promises about its security and its conditions for a peaceful settlement. On the other hand, he was open in his criticism of the Palestinians who are still waiting for their rights to be addressed.

The “doctrine” speech was a good step in the right direction, but insufficient to deal seriously with the changes in the Arab world or to prove that America has undertaken “reform” of the mentality that shapes its policies in the region. Achieving justice for the Palestinians remains the true test facing Obama and others who want to be reconciled with the hearts and minds of the Arabs. As long as Israel represents the US’s overriding interest in the Arab world, no amount of fine words will create harmony between the interests of America and those of the Arab people.



SUSTAINABLE ENERGY

The twin elements of sustainable energy are energy efficiency and renewable energy. Meeting the growing needs for energy now without jeopardizing future supplies has become a major concern of nations. Harnessing energy generated from natural resources which are renewable goes well back in the history of mankind.

There is ample evidence of the rising importance of sustainable energy. The utilization of alternative energy has spread from the industrial to the developing countries over the past decade. Related regulations, budget allocations and environmental stipulations are being carefully formulated worldwide as concerns over the deterioration of the earth's ecosystem are intensifying.

The question is whether these gradual changes in attitudes as well as breakthroughs in new technologies can help to control our future reliance on fossil fuels.

The story of the supremacy of the oil and gas over other fossil sources may be summarized by a single term, namely technology.

An official once said:

“The Stone Age came to an end but many stones still exist in the world”

It is important to remember that technological innovation and the associated capacity for future energy development are limited only by the restrictions of the human mind. The petroleum industry itself may be the best model to confirm this state of affairs. The latter part of the 19th century saw the rise of the petroleum industry and witnessed its supremacy over coal by the beginning of the second quarter of the 20th century. Nevertheless, as a finite source of energy it may very well be replaced by renewable and cleaner sources, depending on the ingenuity of the human mind in commercializing technological innovations.

The Journal of Sustainable Energy is produced bi-monthly. As with all other MEES products, a specialized team of world renowned experts will lead this publication, and supply professionals, investors and students with an in-depth analysis of the trends in this vital industry, with particular emphasis on the Middle East Region.

AMERICA AND THE DEMOCRATIC SPRING

Salama Ahmad Salama

(Published in the independent Egyptian daily al-Shorouk, 23 May – MEES translation)



In his first speech that he delivered at Cairo University two years ago, US President Obama promised a new beginning for America's relations with the Arab world, to repair the damage done during the years when George W Bush was president. The latter directed US policy as a whole towards Israel, after the adventure of the American invasion of Iraq. Throughout the past two years, the Arabs have been waiting – in vain – for the US administration to adopt a balanced position in the Arab-Israeli conflict and stop the rapid deterioration of the peace process between Israel and the Palestinians. But the weakness of the US administration and its bias towards undemocratic Arab governments, hated by their people, shackled Obama's hands. He made no progress in the peace process, and the Arab people received insufficient US support in their struggle for freedom and democracy.

It seems that no one was expecting a significant change when Washington announced a few days earlier that President Obama would deliver a speech on the Middle East in which he would express his vision of the Arab democratic spring, and the revolutions and other developments associated with it. Indeed, the speech was, as usual, empty – it contained no changes or proposals worth mentioning. On the problem of the Arab-Israeli conflict, the Arabs might have congratulated themselves because Obama reaffirmed the previous vision and positions about the need to establish two states on the basis of the 1967 borders, with changes agreed by the two parties. But he went into no other details about refugees, a freeze on settlements or Jerusalem. And he made it a condition that the Palestinians recognize the Jewish state. But Obama sidestepped completely the awkward issue of the mechanisms needed to compel the two parties – and Israel in particular – to implement any agreement. It seems he knew that Israel would reject his proposals. Indeed, Netanyahu wasted no time in announcing that Israel would not accept a return to the 67



It takes **6.5 seconds*** for consumers to engage with an idea. Or reject it. So in 6.5 seconds, we don't tell them what matters to us. Only what **matters** to them. This is our version of ROI - **Return On Ideas**SM.

*Draftfcb global research - www.draftfcb.com

Abu Dhabi Amman Athens Beirut Cairo Dubai Jeddah Kuwait Riyadh

**HORIZON
DRAFTFCB**



borders because they were indefensible, nor would he negotiate with the Palestinians as long as Hamas stuck to its position of not recognizing Israel. He also rejected the US proposal to stop building settlements in order to open up the path towards peace negotiations and insisted that Israel would make no further concessions for peace.

Perhaps what raised the hopes of Egyptians most was one positive element in the American position. The US administration is prepared to help democratic change in the region with respect to economic development, support for policies leading to stability, and the speeding up of recovery to ensure free and fair elections. Obama promised to write off \$1bn of Egypt's debts and allocate \$1bn more for infrastructure projects, and for the development and employment of young people.

This is a tiny amount in the scheme of things. Perhaps the language that Obama was using was new in a way, but it still laid bare the complete lack of content. It is clear that the Arab-Israeli conflict is not the US's top priority. Why? Because an element of the conflict is still the interplay between the two Palestinian powers. Thus far they have achieved reconciliation on paper, but it has yet to be put into practice.

In the coming week we will witness a new chapter of Israel sheltering behind a wall of Republican arrogance – the party that, with the support of the Zionist lobby in Congressional circles, opposes peace. For Netanyahu justifies his reasons for Israel not returning to the 67 borders by claiming the right to self-defense and the survival of the Jewish state.

At the same time, Washington is trying to defeat any attempt by Palestinian President Mahmud 'Abbas to bring up the issue at the United Nations in September and secure a resolution giving the Palestinians the right to set up their own state. America has threatened explicitly to use its influence to prevent the Palestinians securing UN support for this request.

If Washington is trying to achieve stability in the region by helping emerging democracies in Egypt, Tunisia and elsewhere, then stability in the true sense of the word will not be achieved without the Palestinians being able to obtain their legitimate rights. It is not logical for Obama to speak about the right of the Syrian and Libyan people for freedom while the Palestinians lack the same rights – just because this happens to be Israel's wish.

Extracts From President Barack Obama's Middle East Policy Speech, 19 May 2011

The Killing Of Osama Bin Laden

Bin Laden and his murderous vision won some adherents, but even before his death al-Qaida was losing its struggle for relevance, as the overwhelming majority of people saw that the slaughter of innocents did not answer their cries for a better life.

By the time we found bin Laden, al-Qaida's agenda had come to be seen by the vast majority of the region as a dead end and the people of the Middle East and North Africa had taken their future into their own hands.

The Arab Spring

The story of this revolution and ones that followed should not have come as a surprise. The nations of the Middle East and North Africa won their independence long ago, but in too many places their people did not; in too many countries power has been concentrated in the hands of a few; in too many countries a citizen... had nowhere to turn, no honest judiciary to hear his case, no independent media to give him voice, no credible political party to present his views, no free and fair election where he could choose his leader. ..

In the face of these challenges, too many leaders in the region tried to direct their people's grievances elsewhere. The West was blamed as the source of all ills a half century after the end of colonialism. Antagonism toward Israel became the only acceptable outlet for political expression... Not every country will follow our particular form of representative democracy. And there will be times when our short-term interests don't align perfectly with our long-term vision for the region. But we can and we will speak out for a set of core principles, principles that have guided our response to the events over the past six months.

Libya, Syria, Iran, Bahrain, Yemen

Now, time is working against Qadhafi. He does not have control over his country. The opposition has organized a legitimate and credible interim council. And when Qadhafi inevitably leaves, or is forced from power, decades of provocation will come to an end and the transition to a democratic Libya can proceed...

The Syrian people have shown their courage in demanding a transition to democracy, and President [Bashar] Assad now has a choice. He can lead that transition or get out of the way...

Our opposition to Iran's intolerance and Iran's repressive measures, as well as its illicit nuclear program and its support of terror, is well known. But if America is to be credible, we must acknowledge that at times our friends in the region have not all reacted to the demands for consistent change with change that's consistent with the principles that I've outlined today.

That's true in Yemen, where President [Ali 'Abd Allah] Salih needs to follow through on his commitment to transfer power.

And that's true today in Bahrain... The only way forward is for the government and opposition to engage in a dialogue. And you can't have a real dialogue when parts of the peaceful opposition are in jail.

Peace Process

We believe the borders of Israel and Palestine should be based on the 1967 lines, with mutually agreed swaps so that secure and recognized borders are established for both states. The Palestinian people must have the right to govern themselves and reach their full potential in a sovereign and contiguous state...

These principles provide a foundation for negotiations. Palestinians should know the territorial outlines of their state. Israelis should know that their basic security concerns will be met.

I am aware that these steps alone will not resolve the conflict, because two wrenching and emotional issues will remain: the future of Jerusalem and the fate of Palestinian refugees.

Extracts From President Barack Obama's Speech To AIPAC, 22 May 2011

US-Israeli Relations

As the nation that recognized the State of Israel moments after its independence, we have a profound commitment to its survival as a strong, secure homeland for the Jewish people... Because we understand the challenges Israel faces, I and my administration have made the security of Israel a priority. It's why we've increased cooperation between our militaries to unprecedented levels. It's why we're making our most advanced technologies available to our Israeli allies... So make no mistake, we will maintain Israel's qualitative military edge.

Fatah/Hamas

I have said repeatedly that core issues can only be negotiated in direct talks between the parties. And I indicated on Thursday that the recent agreement between Fatah and Hamas poses an enormous obstacle to peace. No country can be expected to negotiate with a terrorist organization sworn to its destruction. And we will continue to demand that Hamas accept the basic responsibilities of peace, including recognizing Israel's right to exist and rejecting violence and adhering to all existing agreements.

Peace Process

A new generation of Arabs is reshaping the region. A just and lasting peace can no longer be forged with one or two Arab leaders. Going forward, millions of Arab citizens have to see that peace is possible for that peace to be sustained. And just as the context has changed in the Middle East, so too has it been changing in the international community over the last several years. There's a reason why the Palestinians are pursuing their interests at the United Nations. They recognize that there is an impatience with the peace process, or the absence of one... I firmly believe, and I repeated on Thursday, that peace cannot be imposed on the parties to the conflict. No vote at the United Nations will ever create an independent Palestinian state. And the United States will stand up against efforts to single Israel out at the United Nations or in any international forum.

1967 Borders

The parties themselves – Israelis and Palestinians – will negotiate a border that is different than the one that existed on June 4, 1967. That's what mutually agreed-upon swaps means. It is a well-known formula to all who have worked on this issue for a generation. It allows the parties themselves to account for the changes that have taken place over the last 44 years. It allows the parties themselves to take account of those changes, including the new demographic realities on the ground, and the needs of both sides. The ultimate goal is two states for two people: Israel as a Jewish state and the homeland for the Jewish people, and the State of Palestine as the homeland for the Palestinian people – each state in joined self-determination, mutual recognition, and peace.

THE SAUDI GAS SECTOR: ISSUES AND CHALLENGES

Bassam Fattouh¹



Introduction:

While playing a minor role in the 1970s, Saudi Arabia's gas sector has witnessed major transformations that have placed it at the centre of the Kingdom's development strategy. In a recent speech, Saudi Aramco President and CEO Mr Khalid al-Falih stated that "the establishment of infrastructure for the gas industry serves as the basis for achieving the goal of economic diversification and provides the vital life blood for the industrial cities of Jubail and Yanbu' and most recently Rabigh". The policy of providing cheap natural gas prices is considered by many Saudi policy makers as central to the success of the diversification strategy and to enhancing the Kingdom's global economic competitiveness as well as key for long-term political and social stability.

While past policies have been successful in increasing the importance of natural gas in the domestic energy mix, they have posed some significant challenges to the current economic development strategy. These include the challenges of securing gas supplies to meet the rapid rise in domestic gas demand and reassessing the current gas pricing policy to reflect the rising marginal cost and opportunity cost of utilising gas reserves. It is now evident that the era of low cost gas production, specifically gas associated with oil production is over. There are increasing signs that the current strategy based on (i) cheap domestic gas prices (ii) a policy of not exporting or importing gas; and (iii) meeting the rapid growth in domestic demand through increasing the pace of exploration and exploitation of domestic gas reserves is facing some serious strains. Policies pursued to deal with these strains, including doing nothing, will have wide implications not only for the future dynamics of the gas and oil sectors in the Kingdom, but also for the wider economy and the long-term sustainability of Saudi Arabia's industrialisation and development path. They also have implications for global energy markets. By meeting domestic needs for fuel, the gas sector currently frees more than 1 million barrels of oil per day (mn b/d) for export². Thus, the policy options currently pursued to meet the challenge of rapidly rising domestic consumption and the choices made on the allocation of energy resources within the Kingdom may have an impact on global oil supplies and prices, especially if current expectations that oil markets will tighten in the future turn out to be true.

¹ Dr Bassam Fattouh is the Director of the Oil and Middle East Programme at the Oxford Institute for Energy Studies; Research Fellow at St Antony's College, Oxford University; and Professor of Finance and Management at the School of Oriental and African Studies, University of London.

² Saudi Aramco, Annual Report 2007, p.22

The Diversification Challenge

Despite continuing efforts to reduce oil dependency, the hydrocarbon sector still constitutes the largest sector of Saudi Arabia's economy, accounting for almost a third of the country's GDP, around 90% of export earnings and almost 90% of government receipts in 2008. The dominance of the hydrocarbon sector extends beyond these direct contributions to economic activity. Government expenditure fuelled by oil revenues is the main driver of public and private consumption. Direct government services are the second largest contributor to economic output after the hydrocarbon sector accounting for 17% of GDP. Government spending is also the main driver of private consumption as the public sector is a key employer of Saudi nationals. In 2008, the public sector employed around 20% of the Saudi national work force. Government spending fuelled by hydrocarbon revenues is also the main impetus behind the growth in the private sector and non-oil output. Recent evidence indicates that apart from their effect on government expenditure, high oil prices do not exert an independent influence on underlying non-oil output in oil-rich economies.

The diversification of the economy has been a top priority for Saudi Arabia. Diversification is considered as key for achieving the goals of sustainable and stable growth, enhancing the role of the private sector, and generating employment. Diversification is also perceived as essential to enhance the Kingdom's integration into the global economy via channels other than the export of crude oil and petroleum products. A central pillar of the diversification strategy centres on the establishment of export-oriented industries that feed on relatively cheap energy sources and that capture the value added of energy resources through extending the energy chain into downstream activities.

The Evolution Of Domestic Gas Demand

With the Master Gas System coming on-stream in the early 1980s, the position of natural gas in the energy mix was transformed. From around 25% in 1980, the share of natural gas in total domestic energy consumption continued to rise over the years reaching 45% in 2004 and declining slightly to 43% in 2008. While in 1970 annual consumption of natural gas amounted to less than 2 billion cubic metres (bcm), in 2009 Saudi Arabia consumed around 77.5 bcm. The Ministry of Petroleum and Mineral Resources estimates that demand for natural gas will rise threefold between 2005 and 2030³.

The rapid growth in domestic gas consumption can be explained by many factors such as improvements in income levels; a rapidly expanding population; cheap gas prices; and industrial policy. Regarding the latter, the policy of providing cheap feedstock to petrochemicals constitutes a key element in fostering the Kingdom's competitiveness in global markets. The Saudi petrochemical industry has witnessed very rapid expansion - accounting for 9 percent of the economy's output in 2008. Its transformation at the global level has been immense. From being a net importer in the 1970s, the Kingdom currently accounts for almost 7% of the global supply of petrochemical products. Nevertheless, the petrochemical sector currently employs around 90,000 employees who constitute only around 3.8% of the Saudi workforce or 1.2% of the total workforce. While extending the energy value chain can in principle help develop more labour-intensive industries, the ability to exploit these opportunities would depend in large part on the dynamism and competitiveness of the private sector and the skills of the domestic labour force.

Another important dimension is the growth in electricity demand. The combination of a general improvement in the standard of living, a fast expansion of the industrial base and low electricity prices has contributed to a rapid increase in electricity demand over the years. Per capita electricity consumption in the Kingdom more than doubled from 2,967 kWh per year in 1984 to more than 7,000 kWh in 2007, an average annual growth of 3.7% during this period. The last three decades witnessed a rapid expansion in power generation with capacity increasing from around 7 Gigawatts (GW) in 1982 to almost 33 GW in 2007 with the average annual growth between 2000 and 2007 exceeding 6%. The Ministry of Water and Electricity expects the power generation capacity to double to 60 GW by 2023. In the original plan, natural gas and/or combined cycle were expected to drive this power generation capacity expansion.

However, there has been a change in policy. In 2006, the government issued a Royal Decree stating that the country's largest future power plants - which were initially planned to rely on gas - will be fired by heavy fuel oil provided at a heavily subsidised price⁴. Thus, in the absence of large gas finds or gas imports, the requirements of any future expansion in power generation and water desalination will be met by liquid fuels, reducing the share of gas in power generation, contrary to the general trend in the rest of the world.

³ EIA, *Saudi Arabia. Country Analysis Briefs, 2008.*

⁴ EIA, *Saudi Arabia. Country Analysis Briefs, August 2008, retrieved online at http://www.eia.doe.gov/emeu/cabs/Saudi_Arabia/NaturalGas.html (October 2009).*



Pricing Issues

Natural gas prices for domestic use in Saudi Arabia have exhibited remarkable stability. In 1984, the government set the natural gas at the price of \$0.50 per mn Btu. This price was maintained until 1998 when it was revised upwards to \$0.75 per mn Btu. To many analysts, the provision of natural gas at a price below the international or regional price constitutes a classic case of a subsidy. However, this issue needs careful analysis in the Saudi context. First, in order to identify whether a subsidy exists, it is important to compare the price charged to domestic consumers with some measure of cost. There is more than one concept of cost: the average cost, the marginal cost and the opportunity cost. The first refers to the overall cost per unit of output and is measured by the sum of average fixed costs and average variable costs. The marginal cost is the increment in total cost resulting from a unit change in output. In sectors such as oil and gas that require heavy capital investment, the average cost and the marginal cost are often very different. While the average cost in these sectors can be high, the marginal cost is comparatively very low. The opportunity cost on the other hand is not related to production costs. Instead, it measures the forgone value of the resource when that resource is not utilised in its best alternative use, e.g. its value in international trade if it can be exported.

During the 1970s and early 1980s, most of the gas produced was in association with crude oil and NGLs. Given that crude oil was the most sought-after item, until very recently gas was treated by the government as a (free) by-product. Consequently, one could argue that the cost allocated to gas production should be set to zero or at most the cost involved in construction and operating the infrastructure needed to capture, treat and distribute the associated gas. Thus, at the early stages of the development of the gas sector, the concepts of average and marginal costs were not relevant. The concept of opportunity cost for natural gas was also irrelevant, as Saudi Arabia does not have the infrastructure to export its associated gas⁵.

As the demand for gas increased over the years, the Kingdom has been under pressure to expand its gas supplies by exploring and developing its non-associated gas fields. This implies that the concept of marginal cost (i.e. the cost of producing an additional 1 cubic metre of gas to satisfy the rising demand) is relevant. However, even in what seems to be a clear-cut case, it is possible to argue that the most sought-after item in the new projects is NGLs while the natural

⁵ This raises the issue of whether Saudi Arabia should aim at exporting gas, especially that the current policy of diverting gas to petrochemicals and energy intensive industries has had so far limited impact on diversification and employment generation.

gas itself can be considered as a (free) by-product. However, given the large spare capacity in liquids, the rapid increase in gas demand, and the recent plans to develop non-associated gas fields (Karan, Arabiyah and Hasbah) it is more appropriate to consider that the most sought-after product is natural gas. Hence, the cost of bringing additional gas supply from more difficult fields, i.e. the marginal cost or the average cost, should be the relevant concepts of cost. The (long-term) marginal or average cost is expected to exceed the current gas price sold to domestic users.

When it comes to power generation and water desalination, the issues are strikingly different and the concept of opportunity cost becomes highly relevant. The rapid increase in energy demand has pushed the Kingdom to resort to burning crude oil/fuel oil in power generation and water desalination plants while diverting natural gas to the petrochemical sector where substitutes are limited. These potentially exportable fuels are provided at a fraction of international prices and hence using these liquid fuels domestically involves a substantial opportunity cost.

Given that Saudi Arabia sits on large spare capacity, the crude oil used in power generation is not destined for exports. Thus, some would argue that the alternative uses of crude oil in the presence of spare capacity are either to leave it in the ground or use it in power generation and water desalination plants. According to this view, the benchmark that should be used in measuring the opportunity cost is not the export price. A natural extension of this argument is that the existence of spare capacity implies that the domestic use of crude oil even at prices below international prices has no opportunity cost. On the contrary, since maintaining spare capacity entails a positive cost then all crude oil not sold internationally should be domestically utilised.

This view however suffers from three major caveats. First, given that OPEC policy is set in terms of production quotas rather than export quotas an increase in domestic oil consumption reduces the country's oil export potential. Second, the availability of spare capacity fulfils a key role in stabilising oil prices in periods of disruption and large shocks to the market. This gives Saudi Arabia a unique position in international energy markets, a position which extends beyond the oil market into the international economic and political spheres. Thus, the reduction in spare capacity due to an increase in domestic consumption implies a positive (though difficult to measure) opportunity cost. Third, the above analysis does not take into account inter-temporal choices. The owner of the resource has two options: either to extract it today or to keep it in the ground for future extraction. Any amount extracted today is not available for extraction in the future. If the price of oil is expected to rise in the future, then the owner has the incentive to hold on to the resource and sell it at a higher international price in the future. So the benchmark that should be used in measuring the opportunity cost in the presence of spare capacity is the future price of oil.

In short, the gas pricing issue requires careful analysis that takes into account a number of factors including the choice of the relevant concept of cost, the availability of spare capacity, and the phenomenon of joint products. However, regardless of the concept of cost used, it is clear that the current gas pricing policy involves a large opportunity cost and needs to be reconsidered. Furthermore, cheap gas prices intensify the gas supply-demand gap by encouraging demand growth and limiting potential supply responses by reducing the incentive for exploration and development and investment in domestic gas infrastructure.

The Supply Side: Patterns And Challenges

Given the strong pressures on the demand side, the Kingdom has pursued a strategy of initiating an aggressive exploration and development of its gas reserves which in 2009 were estimated at 7.92 tcm accounting for around 4% of the world's proven reserves. The future success of such a supply strategy depends to a large extent on the prospects of discoveries in the Empty Quarter. However, hopes of transforming the Empty Quarter into a non-associated gas-producing region seem to be fading. Consequently, the Kingdom has decided to turn its attention to developing more challenging onshore and offshore fields. The Karan field, the first non-associated offshore gas increment in the history of the Kingdom, has been fast-tracked to be completed in 2012. The sense of urgency has also pushed Saudi Aramco to fast track the development of other offshore non-associated gas fields such as Arabiyah and Hasbah. One distinguishing feature from the past is that these offshore non-associated gas fields with high sulphur levels are more expensive to develop while Saudi Aramco is committed to sell gas to its domestic customers at a fraction of the development costs.

Conclusions

Rather than widening its options to deal with the 'gas challenge', Saudi Arabia is likely to continue with its main strategy based on expanding its gas reserves to meet the expected growth in domestic demand. However, there are signs that the current strategy is facing some strains. Unlike other countries, the Kingdom is fortunate in that it can always rely on its massive oil reserves to continue with the current policies and to hedge against the potential failure of achieving self-sufficiency in gas. However, this would be far from ideal and such a policy would involve serious political and economic costs. It is the ability of the policy-makers in the Kingdom to show a greater degree of flexibility and to make some hard choices today that will ultimately determine the evolution of the gas sector in the next few years and with it the country's economic path ahead and Saudi Arabia's future position in international energy markets.

OIL MARKET STABILITY: LEARNING THE LESSONS OF 2008

Dr. Aziz Yahyai & Douglas Linton*



Introduction

For most of last year, the oil market enjoyed a period of relative stability, with oil prices moving in a broadly stable range of \$70-\$85/B. However, starting in mid-November, US benchmark crude oil prices broke above the \$90/B mark, on the back of the early onset of winter weather as well as improving expectations for economic growth supported by increased fiscal stimulus. Some forecasts pointing to a strong revival in crude oil demand and a perceived potential for tightness in the market over 2011 also contributed to the price rise by giving grounds for a surge in speculative activities. The upward trend in crude oil prices has continued since then, driven higher by events in the MENA (Middle East and North Africa) region and a growing risk premium, which returned prices to levels last seen in September 2008. Benchmark ICE Brent moved above \$120/B while WTI reached just under \$108/B. Despite this sharp rise, prices remained below the excessively high levels seen in 2008, when futures prices hit a record high of \$147/B before collapsing to as low as \$34/B.

Recent events have some institutions and financial firms projecting a potential tightening in the oil market over the course of the year, with prices returning to, or even exceeding, the record levels seen in 2008. In light of these expectations, it is worth taking a moment to recall the factors behind the extreme price swings in 2008 and to consider whether the current market situation might be similar.

Oil Market Fundamentals In 2008

At the end of 2007, crude oil prices stood close to \$90/B. Seven months later, prices had spiked almost \$60/B higher and then collapsed by more than \$110/B in little over five months. A review of supply/demand developments during

* Dr. Aziz Yahyai is Senior Research Analyst, Petroleum Studies Department, OPEC. Email: ayahyai@opec.org Mr. Douglas Linton is Research Specialist, Petroleum Studies Department, OPEC, Email: dlinton@opec.org

that year shows that changes in oil market fundamentals were not the driving factor behind this excessive price volatility. Indeed, over this period, market fundamentals had either stabilized or were weakening. Overall, the market was characterized by:

- **Deteriorating Economic Conditions:** During the run up in prices, world GDP growth expectations for 2008 were revised down from 4.7% in January to 4.0% in July and to 3.6% in December. This was due to the onset of the financial crisis which preceded and contributed to the deep recession.
- **Significant Downward Revisions To World Oil Demand Growth:** As a result of the deteriorating economic situation, world oil demand growth forecast for 2008 was revised down from 1.3 mn b/d in January to 1.0 mn b/d in July and showed a contraction of 0.8 mn b/d by December.
- **Relatively Unchanged Supply Picture:** Non-OPEC supply growth forecast for 2008 remained unchanged during the run up in prices between January and July, at 0.6 mn b/d, but was revised down to 0.1 mn b/d by December. The forecast for OPEC natural gas liquids (NGLs) remained steady throughout the period, with a projected increase of an additional 500,000 b/d.
- **Opec Production Higher Than The Demand For Its Crude:** Despite the overall balanced market, OPEC continued to produce well above the demand for its crude. In fact, between January and July, OPEC increased production by a further 300,000 b/d and then added 200,000 b/d in August. Over the entire period, OPEC production remained well above demand, indicating a well-supplied market. Moreover, at a meeting of major oil producing and consuming countries in Jiddah on 22 June 2008, Saudi Arabia announced a 500,000 b/d increase in production.
- **Increasing Opec Spare Capacity:** Despite increased OPEC production, OPEC spare capacity is estimated to have increased by more than 0.5 mn b/d to about 3.0 mn b/d between late 2007 and end 2008.
- **Comfortable Levels Of Oecd Commercial Inventories:** Commercial stocks in the developed countries remained in line with the five-year average for the entire period. Moreover, when prices peaked in July, OECD commercial inventories stood at a healthy level of 56 days of forward cover. A clear indication of the healthy level of supply was the market structure's switch to contango in May, where it remained for the remainder of the year.

Some analysts have argued that the driving factor behind the oil price spike was tightness in the middle distillates market. While the heating-oil crack spread did reach a high level of \$36/B, this peak came on 22 May, almost two months before crude oil prices hit record levels. After peaking, the heating-oil crack spread fell back to \$25/B before plunging sharply with the onset of the economic crisis. While strength in the heating-oil market certainly provided support for crude oil prices through May, it was hardly sufficient to fully explain the price rally that year.

Overall, it is clear that fundamentals alone do not provide a credible justification for the massive price swings seen in 2008. To fully understand the forces driving prices over this period, it is necessary to take into account the impact of non-fundamental factors. Key among these has been the emergence of oil as an asset class, a development which has transformed the oil market and served as an important driver behind the extreme price volatility seen in 2008.

Emergence Of Oil As An Asset Class

The peak in crude oil prices seen in 2008 was part of a general upward price trend that began in 2003. This coincided with a dramatic expansion in activities in the paper oil markets, facilitated by market deregulation following the passage of the Commodity Futures Modernization Act of 2000. As a result, commodity markets became vastly more diversified and experienced a significant change in the composition of participants and trading technology. The unprecedented growth in the worldwide volume of exchange and over-the-counter (OTC) derivative instruments amid sustained increases in oil prices raised concerns about the growing impact of speculation on the crude oil market.

Previously, oil derivatives markets were primarily used for hedging purposes. Investor involvement in the oil sector was mainly through equity positions in oil companies, and financial firms had relatively limited exposure to oil.

The push to develop commodities as an asset class has its beginning in an influential study published in 2005¹. The paper constructed an index of various exchange-traded commodities and reviewed the returns the index would have generated versus established asset classes in the period 1959 to 2004. The study concluded that commodity

¹ Gorton, Gary B. and Rouwenhorst, K. Geert, *Facts and Fantasies about Commodity Futures* (February 28, 2005). Yale ICF Working Paper No. 04-20. Available at SSRN: <http://ssrn.com/abstract=560042>

FREE!
For Project Sponsors
& Developers To apply email:
smilton@icbi.co.uk

**BOOK BY
6 May 2011
SAVE up to
£800!**

The 18th Annual



**Projects & Infrastructure
International**






28 – 30 June 2011
The Hotel, Brussels

www.icbi-projects.com

**10%
Discount**
Quote VIP code: FKN3A6DMESAD

Optimizing New Structures & Sources Of Finance For Infrastructure & Energy Projects Globally
Energy • Oil & Gas • Renewables • Transport • PPP • Mining • Telecoms • IWPP

**Hear The Latest News On The Financial Markets From
Leading Projects Financiers & Lenders**

 Andrew Jameson GM, Structured Finance BTMU	 Noburu Kato GM, Co-Head, Structured Finance SMBCE	 Alexandra Boleslawski Global Head Of Power CA-CIB	 Matthew Vickerstaff Global Head Of Infrastructure SOCIETE GENERALE	 Michael Redican MD, Debt Capital Markets DEUTSCHE BANK
---	---	---	--	--

Understand Export Credit, Multilateral & Public Sector Financial Initiatives

 Peter Ahlbrecht Hd Dept Project Finance and Ships EULER HERMES	 Al Hamdani Vice-President, Project Finance EDC	 Fumio Hoshi Executive Director CA-CIB	 Carolina Lonetti Senior Policy Underwriter SACE	 John Schuster VP, Structured Finance Division US EX-IM
 François Bergère Secretary General MAPP	 Victor Hoek Head of Project Finance ATRADIUS	 Arun Sharma CIO, Global Financial Markets IFC	 Laurent Demy Deputy CEO & CIO PROPARCO	 Mary Merveenne MD, Structured Finance Group OPIC

**Find Out About The Project Development Pipeline From
Energy & Infrastructure Project Sponsors & Investors**

 Derek Rozycki Executive Director, Project & Corporate Finance MUBADALA	 Owen Michaelson Managing Director (Property) UK COAL	 Fintan Whelan Co-Founder & Corporate Finance Director MAINSTREAM RENEWABLE POWER	 Karel Breda Head of Acquisitions, MENA GDF SUEZ ENERGY INTERNATIONAL	 Mikael Karlsson CEO GLOBEIQ
--	---	---	---	---

**Your Guide To Projects &
Infrastructure International 2011**

**NEW: Project Finance Thought
Leadership Forum**

Wednesday 29 June – See p. 2

Projects & Infrastructure International presents thought leadership from the market's leading analysts and practitioners. You will take home a comprehensive overview of the political and economic factors driving infrastructure and energy development globally.

**NEW: The Renewables, Transport &
PPP Forums**

Thursday 30 June – See p. 3

The only event that will give you a comprehensive view of the project development pipeline and how to close deals across all sectors. In 2011 we are bringing you even more in-depth content, deal case studies and networking opportunities with experts from the Renewable energy and Transport sectors, as well as the latest news on PPP practitioners in the market. You can visit any of the sessions across the 3 focussed summits.

NEW: 2 Pre-Conference Summits

Tuesday 28 June – See p. 4

In 2011 the popular Oil and Gas Summit will run concurrently with the Infrastructure Transactions Summit. Delegates in each summit will not only benefit from the wealth of expertise at each summit, but will also enjoy the opportunity to network with their colleagues from the other summit.

Who Will You Meet In 2011?

- ✓ Project Sponsors & Developers
- ✓ ECAs
- ✓ Multilateral Agencies & DFIs
- ✓ Infrastructure Funds & Investors
- ✓ Ratings Agencies
- ✓ Banks & Commercial Lenders
- ✓ Lawyers & Financial Advisors
- ✓ Market analysts, region & sector specialists

Choose From 2 Essential Pre-Conference Summits - Tuesday 28 June

Financing Oil, Gas & Petrochemicals Projects

Hosted by **SULLIVAN & CROMWELL LLP**

- The Oil and Gas summit is recognised as the only place to find out how mega oil and gas deals are being financed and how successful deals have been structured.
- Attended by major NOCs & IOCs this is a must attend event for anyone involved in the financing of major up, down and midstream projects and your opportunity to find out what global developments are in the pipeline for the coming year and what are the key factors driving the market.
- Featuring deal case studies from project developers as well as political and economic expertise from local practitioners and financiers.

Structuring Finance For Infrastructure Transactions

- Back by popular request, The Structuring Finance For Infrastructure summit is an opportunity to meet the funds, investors and asset owners driving the infrastructure deal pipeline, as well as understand the current nature of financing transactions.
- This is an essential summit wishing to get an insight into: the appetite for infrastructure assets, recent performance across different sectors, capacity and availability of finance for new acquisitions and refinancing, as well as new approaches to driving finance and funds into infrastructure.
- The summit will feature insights from leading Infrastructure funds and investors including: Ancala Partners, Hadrian's Wall Capital, AMP Capital, Goldman Sachs, Morgan Stanley, Ferroviario and EDC.

Associate Sponsor  Endorsed by 

28 June 2011: Financing Oil, Gas & Petrochemicals Summit
Structuring Finance For Infrastructure Transactions Summit

29 – 30 June 2011: Main Conference
The Hotel, 38, Boulevard de Waterloo, Brussels



To Register: Call +44 (0) 20 7017 7200, Fax: +44 (0) 20 7017 7807, Email: info@icbi.co.uk
For the latest programme please visit: www.informaglobalevents.com/FKN3A6DMESAD

returns were negatively correlated with equity and bond returns, and positively correlated with inflation. This implied that commodities increase in value during periods when other assets such as equities and bonds are losing money. Growing awareness of commodities' role in diversifying risk and as a hedge against inflation was a key factor in the widespread acceptance of oil and commodities as a financial asset. This marked the start of a massive inflow of institutional investment into commodities, through passive, long-only indexes, such as the S&P GSCI, Dow Jones-UBS and Thomson Reuters/Jefferies CRB.

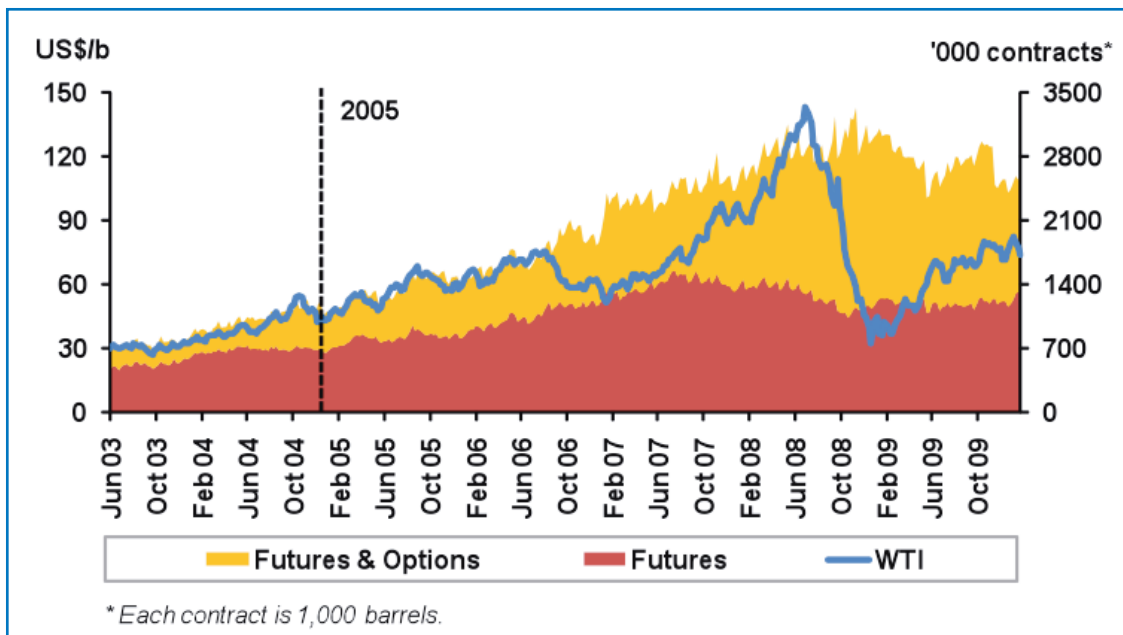
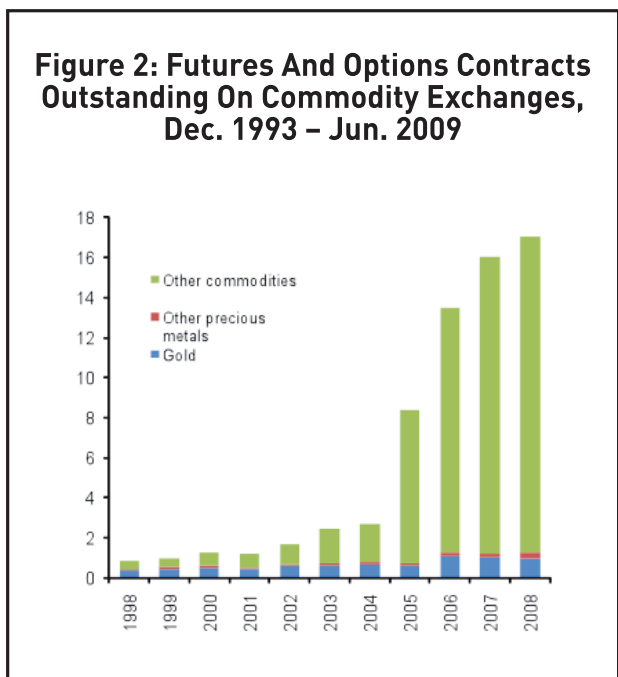
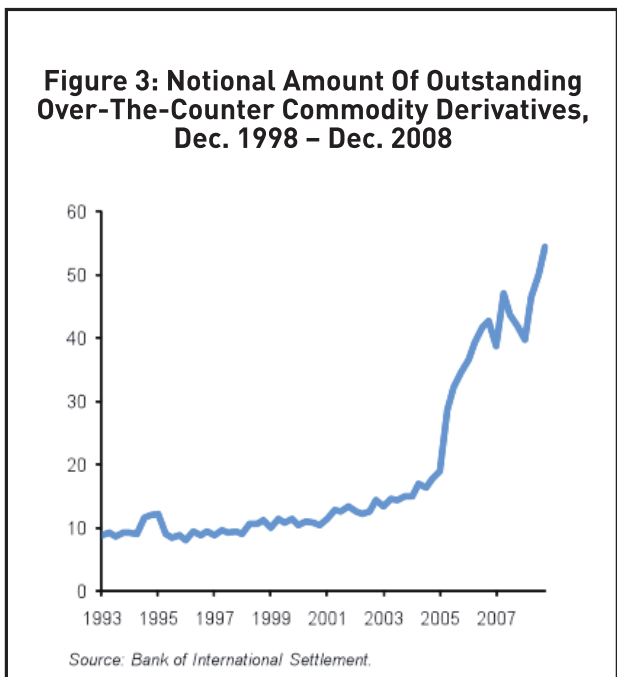


Figure 1: Oil Prices And Open Interest Volume, Nymex Wti

With the deepening of the paper-market and prospects for higher returns, money began to move into various types of oil-backed financial products. New asset management strategies, financial product innovation, and the development of new institutional forms of investing, such as index investing in commodities, paved the way for greater financialisation of the oil industry.

As a consequence, the volume of money going into paper-oil has increased and trade volumes have risen dramatically on both the regulated exchanges (figure 1) and the unregulated OTC markets. From early third quarter 2003 until the end of 2008, a strong uptrend in volumes has been observed, particularly for options on futures. Bullish forecasts for world GDP growth and oil demand, lax monetary/credit policies, historically low interest rates and strong oil sector fundamentals created an investment environment conducive to attracting money into paper-oil. Between 2002 and the financial crisis that hit the world in 2008, the number of futures and options contracts outstanding on commodity exchanges worldwide more than tripled, while the notional value of commodity-related contracts traded outside the



regulated exchanges increased more than 14 times (see figure 3).

The financialisation of crude futures trading has also made the oil market even more prone to overshooting as there is a larger share of market participants, sometimes with very large positions, that do not trade based on fundamental supply and demand relationships, but nevertheless influence crude oil price developments.

The crude oil price spike that took place in 2008 provides a good example of this. In the first half of the year, participants in the paper-oil market were promoting a message that a perceived tightening in the oil market's supply and demand balance would push prices to \$200/B. On that basis, they were encouraging investors to share in the profits to be made from the sharp rise in prices. The availability of easy credit and high levels of leverage sustained the inflow of money, allowing the price rally to continue.

These prophecies became self-fulfilling, leading to an overshoot of prices way above the levels justified by fundamentals during the first half of 2008. In less than five months, the oil price collapsed by more than \$110/B from the peak price in mid-July 2008. This was not only the result of changing economic prospects, but also due to a revision of exaggerated expectations.

It is important to note that other commodity markets were also pushed to excessively high levels over this period. Between 2005 and the onset of the crisis in 2008, agricultural commodities such as corn and wheat rose by 96% and 89% respectively. In the metals complex, silver increased by more than 100%, while gold rose by 95%. This compares to an increase of close to 90% in crude over the same period.

Continued Impact Of Financial Markets On Oil Prices

With the emergence of oil and commodities as an asset class, oil can no longer be viewed and treated as merely an industrial commodity. It now also serves as a financial asset. As has been noted, financial investors enter commodity markets for portfolio-diversification reasons that are largely unrelated to supply and demand fundamentals. As a result of these financial inflows, commodity prices are being increasingly impacted by events in the broader financial markets. Such volatility creates confusing price signals, and thus undermines the primary functions of the futures market, which are price discovery and the hedging physical risk.

The correlations between crude prices, equities and currency markets which have emerged since the financial crisis highlight the impact of investment flows into the crude oil market. Following the subprime crisis and the subsequent weakening of the US dollar, investors switched their positions largely from the US currency market to commodities in general, particularly crude oil. As a consequence, the correlation between crude oil prices and the US exchange rate has been strong, particularly since July 2007. The downward trend in the value of the US dollar was broken in July 2008, which contributed to the sharp fall in crude oil prices.

Since the onset of the financial crisis, crude oil prices have also shown a correlation with equities, which act as an indicator of economic sentiment. This contrasts with the relationship prior to the financial crisis when equities showed a negative correlation with commodity prices – one of the main arguments for adopting commodities as an asset class.

Efforts To Enhance Regulation In The Financial Oil Markets

Following the upheaval caused by the financial crisis of 2008, as well as the spike in commodity prices that preceded it, there is now a broad consensus among policy makers at the highest levels about the need to enhance regulation and oversight in the financial markets in order to avoid any repeat of the destructive volatility seen in 2008. Initiatives include efforts to enhance transparency on the established exchanges, establish positions limits for speculative traders in oil derivatives as a whole, and create a regulatory and trading framework for the currently opaque OTC market.

The overall direction for much of these efforts, particularly with regard to the OTC, is being set at the G-20 level. Given the global nature of markets, such an international effort is crucial as it reduces the risk of regulatory arbitrage, which could inadvertently act as an incentive for financial players to move to a lesser regulated jurisdiction.

Some argue that statistical research has yet to prove a causality about the impact of financial markets on the price of oil. However, due to the lack of adequate oversight in the financial oil markets, the necessary data for proper statistical testing does not currently exist. Ensuring that regulators and the general public as a whole have a clearer picture of the extent of speculative activity is one of the key aims of the effort to increase transparency in the commodity futures markets, and all the more reason that these efforts should move forward.

The lessons learned in 2008 clearly demonstrate the risks associated with inadequate regulation and oversight in the oil derivative markets.



Comparison With Current Oil Market Situation

After enjoying a relatively stable period for most of last year, crude oil prices have experienced resurgence in volatility in 2011. The upward price rise dates back to mid-November of 2010, when WTI crude oil prices moved above the \$90/B mark, on renewed fiscal stimulus, particularly in the US, and improving expectations for world economic growth. This provided an incentive to invest in commodities such as oil, which proved to be a key driver behind the upward movement in prices.

The upward rise in crude oil prices continued into the early months of 2011, driven by events in the MENA region, resulting in a growing risk premium. Prices spiked higher in February with the onset of the crisis in Libya as well as concerns that supply disruptions could spread to other producers in the Middle East and North Africa. Supply concerns and the associated risk premium were dampened to some degree by the triple catastrophe in Japan, resulting in a disruption in the country's energy complex and leading to a sudden decline in the country's use of oil. Continued concern about supply disruptions continued to push prices higher throughout April.

However, on 5 May, crude oil prices plunged, with Brent futures shedding over \$10/B, and on the following day, prices fell even further. This sharp correction was the result of a huge sell-off in commodity markets including oil, which triggered profit-taking, as losses gained momentum. For the week, both WTI and Brent experienced a correction of almost \$17/B, the sharpest weekly decline on record.

Since then, crude prices have remained volatile as the recent strong technical 'correction' in crude oil prices has made market participants nervous about any further sudden drop in prices. Volatility in product markets, specifically gasoline, has also resulted in large fluctuations in crude prices ahead of the summer driving season.

While prices have seen renewed volatility, crude oil market fundamentals in 2011 are very different from the situation in 2008, with key indicators showing that the market remains well supplied.

- **Higher Opec Spare Capacity:** By the end of 2010, OPEC spare capacity reached about 6 mn b/d. Even with the partial shutdown in Libyan production, OPEC spare capacity remains above the 3.0 mn b/d level seen in 2008.
- **Higher Global Supply Growth:** In the first quarter of this year, growth in non-OPEC supply including OPEC NGLs reached 1.3 mn b/d, compared to only 100,000 b/d in 2008.

- **Higher Global Stocks:** In terms of forward cover, OECD commercial oil stocks stand at 58 days compared to 56 days in 2008. In China, crude stocks currently stand at 320 million barrels, up from 230 million barrels in 2008, providing a further cushion to the market in the case of higher-than-expected demand in this important emerging economy. Additionally, the contango structure in the market has led to a build of 68 million barrels in floating storage, which can be supplied immediately to the market. In 2008, floating storage only began to build at the end of the year.

These factors underscore the fact that current market fundamentals are much softer than in 2008, which should help to dampen the excess price volatility affecting the market. Despite this, crude oil prices still remain at high levels – out of step with the realities of supply and demand.

The buildup of large speculative positions on the crude futures markets has been a key factor behind the increased volatility in crude oil prices. In early March, speculative net long positions held by money managers on the Nymex hit a record high of 274,000 contracts. Since then, speculative activity has decreased but still stands close to historically-high levels.

Other financial factors are also playing a role. Some market observers have likened this sharp drop in prices in May to the ‘flash crash’ seen in the equity markets last year, when the Dow Jones Industrial Average plunged around 900 points – the biggest intraday decline in Dow history – only to recover in a matter of minutes. In both cases, automatic computerized trading is believed to have helped to facilitate this exceptional volatility. Given that High Frequency Trading (HFT) and algorithmic trading account for a considerable share of all trading volume in the oil futures market, this development certainly warrants closer attention.

Addressing The Impact Of Excessive Speculation

Recent developments underscore the essential role that the futures market plays in establishing price levels for the oil market as a whole. The interaction of buyers and sellers on the futures exchanges helps to determine price levels that serve as benchmarks for the global oil trade. At the same time, futures markets allow producers and consumers to hedge or offset price exposure to physical commodities.

Within these interactions, traditional speculators play an important role in providing strategic liquidity when producer and consumer hedging demands are not equal as well as tactical liquidity when the timing of producer and consumer hedging demands do not match. In this way, speculators can contribute to the smooth functioning of the market.

At the same time, with the rapid expansion in financial flows into the commodity markets since 2005, the risks of excessive speculation must also be acknowledged. As we have seen, excessive speculation in the futures markets increases volatility unrelated to fundamentals and, in this way, distorts the essential price discovery function of the market. Noise and momentum traders can increase volatility and cause prices to over- or undershoot. Moreover, financial flows into oil for the purpose of asset investment can cause oil prices to detach from fundamentals, potentially leading to price spikes and collapses, as seen in 2008. This not only distorts price discovery, it also undermines the hedging function of the market, as wide price swings reduce the effectiveness of hedging.

While it is recognized that volatility cannot be eliminated, there is widespread agreement that excessive swings are undesirable. Given the locations of the major exchanges, efforts to minimize the effects of excessive speculation in the financial oil markets will need to be carried out by the governing and regulatory bodies in consuming countries, and the progress made so far has been encouraging.

Indeed, markets have evolved significantly since the last period of regulatory change, and the recent financial crisis has underscored the fact that financial regulation and financial innovation need to develop in tandem. In this regard, the current initiatives seek to give regulators the necessary mandate and tools to adequately monitor and regulate the market. Given the sums involved, there is considerable opposition to these efforts by the firms who have been profiting from excessive speculation, in an attempt to derail, delay or water-down the necessary proposals. However, the lessons of 2008 – and the renewed volatility in oil prices seen so far this year – confirm the pressing need to update the regulatory framework.

Oil producing countries are certainly following these developments closely and welcome efforts to enhance oil market stability. In an industry of long lead times and high capital costs, excessive volatility creates unsuitable investment conditions and undermines the ability of the industry to adjust to market changes.

In closing, it is important to note one comforting lesson from the excess volatility seen in 2008. Even under the extreme volatility seen during that year, the market continued to function, with no disruptions reported in physical supply. This highlights the overall resiliency of the global crude oil market, in which OPEC plays an important contributing role.

THE IRAQI ECONOMY 2011-2014: STRATEGIC CHOICES (MEES Translation)

Kamal al-Basri*



There is universal acknowledgement of the importance of “joint private-public sector contracts” in establishing infrastructure and in providing quality services. In this study we attempt to highlight the strategic importance of such contracts in the context of the difficulties faced by the Iraqi government in providing basic services.

Are Joint Private-Public Sector Contracts The Economic Strategic Choice For Iraq?

We will address the subject by highlighting:

Firstly: the importance of joint private-public sector contracts.

Secondly: the fact that the current investment climate does not encourage direct investment, and that there are difficulties in implementing projects on time and to the required standard for administrative and technical reasons.

Thirdly: how, when we view the estimates of government revenues and investment allocations projected for the period 2011-2014, we find there is a shortfall, and the investment gap needs to be filled from other sources. Otherwise the suffering of Iraqis will continue because of the lack of services and the inability to raise human development indicators.

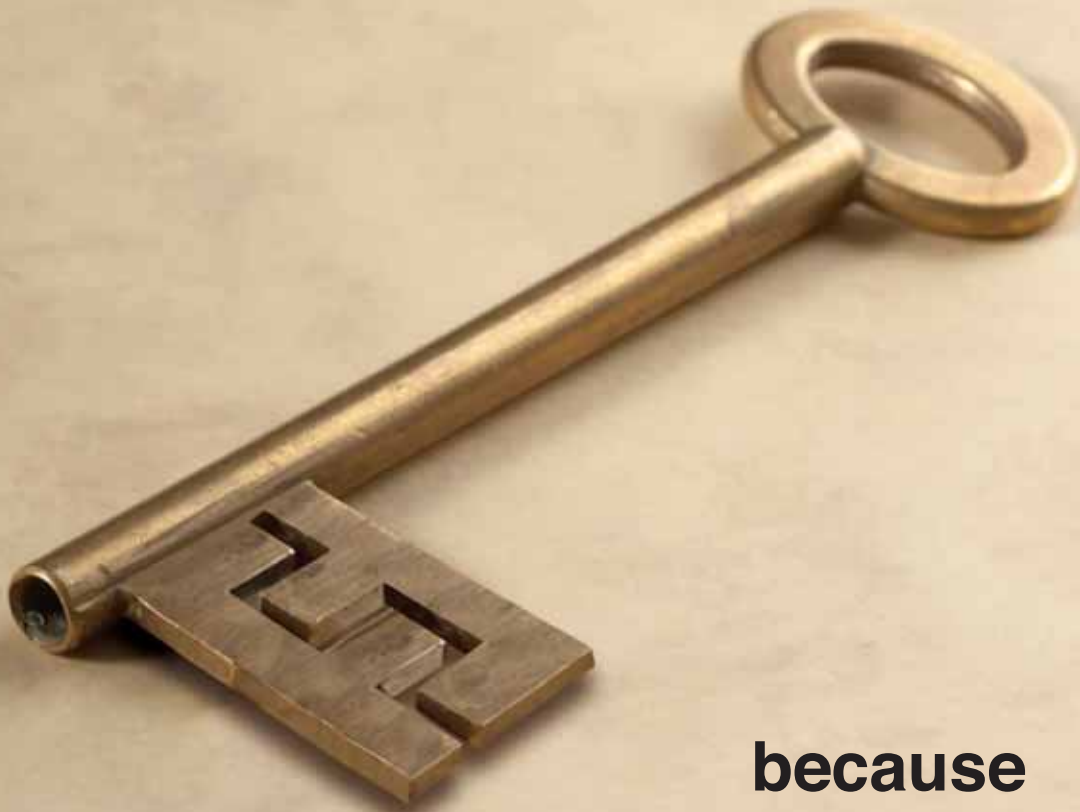
Joint private-public sector contracts not only provide the necessary cash liquidity, but they also enable modern technology transfer and the introduction of modern management practices. They constitute, too, a critical means by which to deal with the sluggishness in both the private and public sectors by speeding up infrastructure development – the failure of which has increased public suffering. These contracts also represent a way of stimulating other economic activities, thus creating employment and GDP diversity.

*Dr. Kamal al-Basri, Iraqi Institute for Economic Reform, Baghdad.



Fenchurch Faris Ltd.

Insurance & Reinsurance Consultants & Brokers



because security is key

Providing expert advice to any foreign or domestic entity on all insurance, reinsurance & risk management matters in the Arab Middle East.

ATHENS MAIN OFFICE

Fenchurch Faris Ltd.
T: +30 210 8947587 • T: +30 210 8945632
F: +30 210 8942549
E: fenchurchfaris@fenfar.gr

GREEK BRANCH

Fenchurch Faris Hellas
T: +30 210 8947518
F: +30 210 8947520
E: fenfarhellas@fenfar.gr

KUWAIT

Fenchurch Faris Ltd.
T: + 965 2 241 4124 • T: + 965 2 241 8371
F: + 965 2 245 7976
E: fenfar@qualitynet.net

ABU DHABI

Fenchurch Faris Ltd.
T: +971 2 674 0981 • T: +971 2 674 0982
F: +971 2 674 0978
E: fenfar@eim.ae

AMMAN

Fenchurch Faris (Jordan) Ltd. (Insurance Brokers)
T: +962 6 4610 293
F: +962 6 4610 296
E: fenchurchfaris@fenfarjo.com

LONDON

Fenchurch Faris Ltd. C/O Heath Lambert Group
T: +44 (0) 20 7560 3000
F: +44 (0) 20 7234 4069
W: www.heathlambert.com

For further information please refer to the fenchurch faris website: www.fenfar.gr

Firstly: The Importance Of Joint Private-Public Sector Contracts

Joint projects: these are contracts that enable the government side (public sector) to award the private sector a concession to set up a particular utility, to operate it, and then return it at an agreed time. During this period the private sector can recoup its investment and clear a profit. For according to the terms of these contracts, the public sector agrees to purchase its services and support its sales price. The best known of these contracts is build, operate, transfer (BOT) – of which various forms exist. These contracts can be applied in the setting up of public utilities like hospitals, ports, railways, and water desalination projects. They offer an alternative to the direct privatization of projects that have been earmarked for this. The most common models for private-public sector partnership are leasing and BOT.

Leasing Contracts:

This is a common contract, by which public utilities are leased to investors, and they are usually of short or medium-term duration. In general, the contract involves leasing the utility to the investor to operate it and provide services from it to the public, in return for rent paid to the relevant public sector institution. The investor must provide services to the public in accordance to agreed guidelines, the most important of which concern the price and quality of service (in addition to a commitment to maintain the utility for the duration of the contract). These kinds of contract are suitable for leasing out central markets, recreation centers, and car parks.

Build, Operate, Transfer Contracts (BOT):

This type of project provides a mechanism for the public sector to legally acquire the benefits of “privatization” without selling the basic investment assets. Particular to the BOT system is the fact that is a legal agreement that takes advantage of private sector financing to implement a project – ownership of which, after a specified period of time, returns to the public sector. And there are many other models.

It is clear from the above that through these contracts the public sector can provide services to the public without having to pay for them. The party paying is the one that is contracted to provide the financial capital, set up the utility, operate it according to a commercial agreement which gives the investor the opportunity to recoup his initial investment and make a profit.

The following are some of the projects suitable for these kinds of contracts: oil refineries; power stations; hospitals; schools; roads and communications networks; water desalination plants; sewerage systems; high-cost transportation systems such as railways or underground trains, etc. This type of contract is suitable for both developed and developing states.

In Britain, these contracts have been used for, among other things, schools, roads, prisons and hospital projects. In Kuwait, the government began using BOT contracts in 1970 when it offered out 10 projects for the establishment of multi-storey car parks and commercial markets, before expanding the scheme to incorporate other projects.

In expressing the need to take advantage of these projects in Iraq, one should stress the economic reality of the country: a weak direct investment environment; and weak economic performance indicators and management capabilities.

Secondly: Weak Business And Investment Environment

A. Weak Investment Environment

In the Ministry of Planning’s National Development Strategy for 2006, the expenditure necessary for reconstruction – to cover the period 2006-2010 – is shown to be the equivalent of \$187bn. When calculating the actual investment allocations in the budgets for that period we find that the total is equivalent to around \$66bn. From this we can conclude that the shortfall in investment was around 65% – thus the need to find other sources of investment financing.

Despite the existence of an investment law that contains many of the necessary incentives, businessmen face challenges:

- Lack of flexibility in state bodies to take the required action, and absenteeism at the workplace, plus various factors related to the lack of administrative discipline.
- The absence of commercial banks that can respond in a flexible way to the demands of businessmen, and the weak presence of insurance companies.



ENERGY & GEOPOLITICAL RISK



Since the later part of the 19th century oil and gas have dominated the lifestyle and welfare of the human species. The pursuit of oil and gas has brought about technological innovations that have produced both beneficial and harmful consequences for the development of human welfare. On one hand they have helped to improve the quality of human life and contributed to the reduction of disease, illiteracy, poverty and insecurity. On the other hand no other source of energy has created such devastating and unabated political instability among nations. The ensuing geopolitical risk identification, management and mitigation with respect to energy sources constitutes a central factor in the modern international relations. Their ramifications cross all boundaries among the mutually dependent economic, political, social and environmental factors that shape the plans and aspirations of nations.

Since November 2008 MEES has produced monthly Special Reports on "**Energy and Geopolitical Risk**" and their determinants. Capitalizing on the MEES weekly publication, with its wealth of news and analysis of energy issues for more than half a century, it reflects the knowledge and experience of its editors and management, as well as the professional opinions of world renowned specialists.

Cross-border behavior is to varying degrees attributable to the uneven distribution of energy resources, which is a significant factor in assessing the ensuing risk profiles of sovereign nations. The security of global supply and demand of energy significantly determines the flow of energy resources and their derivatives to their intended destinations within a stable price régime. This position is further enhanced as the world is increasingly interconnected and characterized by irreversible dynamic interdependence.

Periodically readers can enjoy "unique interviews" with regional government and private sector leaders, in conjunction with focused analysis".

These and other factors have contributed to making the investment climate weak, compared to other countries. Looking at the annual survey carried out by the World Bank, "Doing Business In Iraq", we find the results reflect the severe degree of difficulties faced when undertaking economic activities. Exceptional measures will be needed to shift this heavy burden. So we need to create appropriate and attractive conditions to draw in qualified businessmen and contractors. We also need to issue instructions to enable the Investment Authority and ministries reduce red tape, secure the necessary approvals and set up a single window of access. We must ensure that controls are in place to guard against lack of integration (to reduce delays in transactions) and introduce a timeframe for the consideration of transactions, while facilitating the opening of bank credits. It is worth pointing out that the role of monitoring agencies was and still is sound in principle, but in practice the agencies have ended up causing considerable delays in doing business.

A comparison of the investment environment in Iraq with those in a group of countries such as Egypt, Iran, Morocco, Malaysia and Singapore for 2008 (using World Bank data collected for the "Doing Business In..." series), we find huge differences and the fact that Iraq's investment climate is one of the most difficult. There can be no doubt that the ease of the investment environment reflects positively on the welfare of the population. We see, for example, that the investment facilities offered by Singapore (a country lacking in natural resources) helped to produce an average per capita income of \$48,000, while the equivalent for Iraq (in 2007) was just \$3,600.

B. Weak Business Environment

Because of the circumstances that Iraq has endured, its population has experienced a deterioration in living standards and the quality of life, combined with the absence of human development indicators of the kind that were available when the country was a power in the region. But by way of an example, the average age in Iraq is 58.2, while the averages in Arab states, developing countries and the world at large are, respectively, 67.2, 55.1 and 68.1. Similarly, if we look at a comparison of those receiving education we find that the figure for Iraq is 74%, while those for Iran, Algeria and Saudi Arabia are 77%, 77% and 78.8% respectively.

The weaknesses that such indicators reveal reflect negatively on citizens' interaction with state institutions, prompting in turn an absence of a sense of responsibility towards the common good and public funds, plus a general lack of respect for the rule of law. Such attitudes have created daunting security, administrative and economic challenges. The past era of dictatorial politics has spawned practices and policies that have done nothing to promote the sense of citizenship. Far from protecting the rights of the individual (physical and moral) dictatorial policies were directly responsible for the neglect of those rights. These measures awoke hatred in the psyche of the deprived citizen that made him take revenge on the state and its property. Unfortunately, the actions of individuals after the 2003 occupation took (and still take) the form of assaults on targets that existed for the public interest. This can be explained by the term 'tyranny of the ego' – where personal interests override public ones. In our view, the main factor exacerbating the problems of administrative and economic corruption in Iraq is the conflict and contradiction between the two interests. And one of the most significant results of this is the problem of weak economic performance on the part of government institutions.

A study undertaken by the author into the factors that adversely affect government-investment performance reveals:

1. External Factors: the effects of security conditions, the controls on monitoring bodies, the absence of investment infrastructure and the rule of law.
2. Internal Factors: in particular the organization of work within the ministry concerned and the lack both of an economic feasibility study and efficient management of contracts, plus the lack of appropriate personnel in the appropriate places and sound administration.
3. The Third Group: factors related to the coordination between government departments, including insufficient cooperation between the various state agencies – as happens with decision relating to (Ministry of Planning), disbursement of government allocations (Ministry of Finance), and opening credits (the Central Bank and the Commercial Bank of Iraq).

The internal factors point to the fact that workers are not fulfilling their roles with the efficiency that is required and poor implementation may be explained by "laxity" on the part of personnel. One must, therefore, find the necessary incentives (moral and material). Or the state of affairs may be explained by their "shortcomings" – which require training and acquiring qualifications so that the appropriate person is put in the appropriate position. Also, a high proportion of weak performance can be traced back to the lack of a sense of responsibility. There is no doubt that raising human development indicators has a role to play in the upgrading of people to enable them to overcome laxity

and shortcomings. This is on the one hand. On the other, the economic blockade of Iraq and war conditions led to a huge deficiency in knowledge and technical skills, which is reflected in the weakness of the administrative and technical teams in executive institutions.

As mentioned above, the economic problem in the implementation of projects is not one of financial resources and allocations. Rather, it is a problem of weak interaction at the personal level with the economic process. It is a problem of a lack of harmony between private and public interests that finds expression in a lack of respect for the rule of law.

Until recently, the pioneers of economic thought stressed the importance of issuing economic reform legislation, without reference to the social element (environment, rule of law). Recently, though, the failure of reform experiments in Russia, Latin American countries and Bosnia, have led some analysts to re-examine the requirements of economic reform.

A learned study by Michael Walker, head of the Fraser Institute, sets out to explain the economic prosperity in certain countries. The study, which covers 135 states, found that the issuing of legislation and the introduction of economic reforms represented an important factor. But the most important one of all was respect for the rule of law. The researcher proved statistically that the relationship between economic prosperity and the rule of law is stronger than that between prosperity and economic reform laws.

Based on the above, we can conclude categorically that raising human development indicators must become a priority above all others. It is difficult for us to imagine a qualitative change in the structure of Iraq's economy without completing the requirements for the restoration of human development. Above all, we can conclude that poor human development indicators play a role in the lack of the necessary cohesion between the individual and public projects.

Thirdly: The Role Of Joint Private-Public Sector Contracts In The Strategy For Iraq's Economy 2010-2014

In order to know the importance of joint private-public sector contracts in providing the necessary financial liquidity to plug the investment gap we must calculate government revenue and expenditure (2010-2014).

Revenue 2010-2014 is divided into:

1. Non-oil Revenues. These have not and still do not exceed 10% of public revenues. We expect to see a gradual development in the future through action to apply the customs tariff (work on this at present has been suspended) and through more efficient collections of dues. At present, these revenues amount to around \$4bn. In order to draw up a plan for these revenues we will assume an average annual growth of 10%.
2. Oil Revenues. The following assumptions regarding the volume and price of oil exports have been calculated according to local production and export capacity, as well as international economic market indicators.

Public Revenues 2010-2014									
Year	Price Of Oil (\$/B)	Oil Exports (Mn B/D)	Revenues (\$Bn)	Non-Oil Revenues (\$Bn)	Total Revenues (\$Bn)	Investment Share	Available Investment Allocations (\$Bn)	Shortfall In Investment Allocations (\$Bn)	Required Investments (\$Bn)
2011	76.5	2.30	63.342	4.000	67.342	0.40	26.937	3.063	30.000
2012	78.5	2.70	76.302	4.400	80.702	0.42	33.895	6.105	40.000
2013	80.5	3.30	95.634	4.840	100.474	0.44	44.209	5.791	50.000
2014	84.5	4.00	121.680	5.324	127.004	0.48	60.962	6.038	67.000
							166.002	20.998	187.000

From the above, it is clear that the shortfall is around \$20bn. And for the reasons mentioned earlier, we cannot rely much on foreign direct investment to plug the gap. Therefore, a possible option is for the government to adopt the policy of "joint private-public sector" structure. Through this, the foreign investor can overcome the danger barrier, assuming the Iraq government is a partner capable of overcoming administrative, legal and financial difficulties.



Fourthly: Conclusions

Based on the above we can say with certainty that joint private-public sector contracts represent the strategic option for the following reasons:

1. In addition to providing the necessary financial liquidity they also enable the transfer of modern technology and the introduction of modern management practices.
2. They represent a critical instrument to deal with the sluggishness in both the public and private sectors, and speed up infrastructure development for the long-suffering citizen.
3. They provide a way to stimulate the establishment of other economic activities, thus creating job opportunities and diversity in the gross domestic product.

On the other hand, these contracts could be a way of squandering financial resources if they are not handled properly. To prevent that from happening it is necessary to move towards accelerating the establishment of an administrative unit or a center specializing in the management of these contracts to ensure that they are put to good use, and for this body to carry out the necessary studies for the contracts, including economic feasibility. For example, in South Africa, a central unit checks out the ability of institutions or provinces to pay their financial dues.

This administrative unit could be attached to the Ministry of Finance (as is the case in Britain) or the office of the Prime Minister (as in Turkey). In Canada, on the other hand, it is the equivalent of a government company, but independent of government departments, with a generous budget to attract qualified personnel by offering excellent pay. In the Philippines, the body is independent of the bureaucratic government administration, and in other countries it is a jointly owned company, with the private sector holding 51% and the public sector 49% – as in India.

As regards vested interests and bias in the taking of decisions, monitoring departments have a very important role to play. Britain's Financial Services Authority reviews decisions relating to these contracts and ensures their objectivity. This administrative unit operates throughout the country and includes different sectors, including local government, in its coverage. But some institutions like prisons and roads authorities have their own special units because of the large size of the contracts.



MAZARS

Audit

Accounting

Advisory Services

Consulting

Mazars in the
Middle East

United Arab Emirates

Qatar

Sultanate of Oman

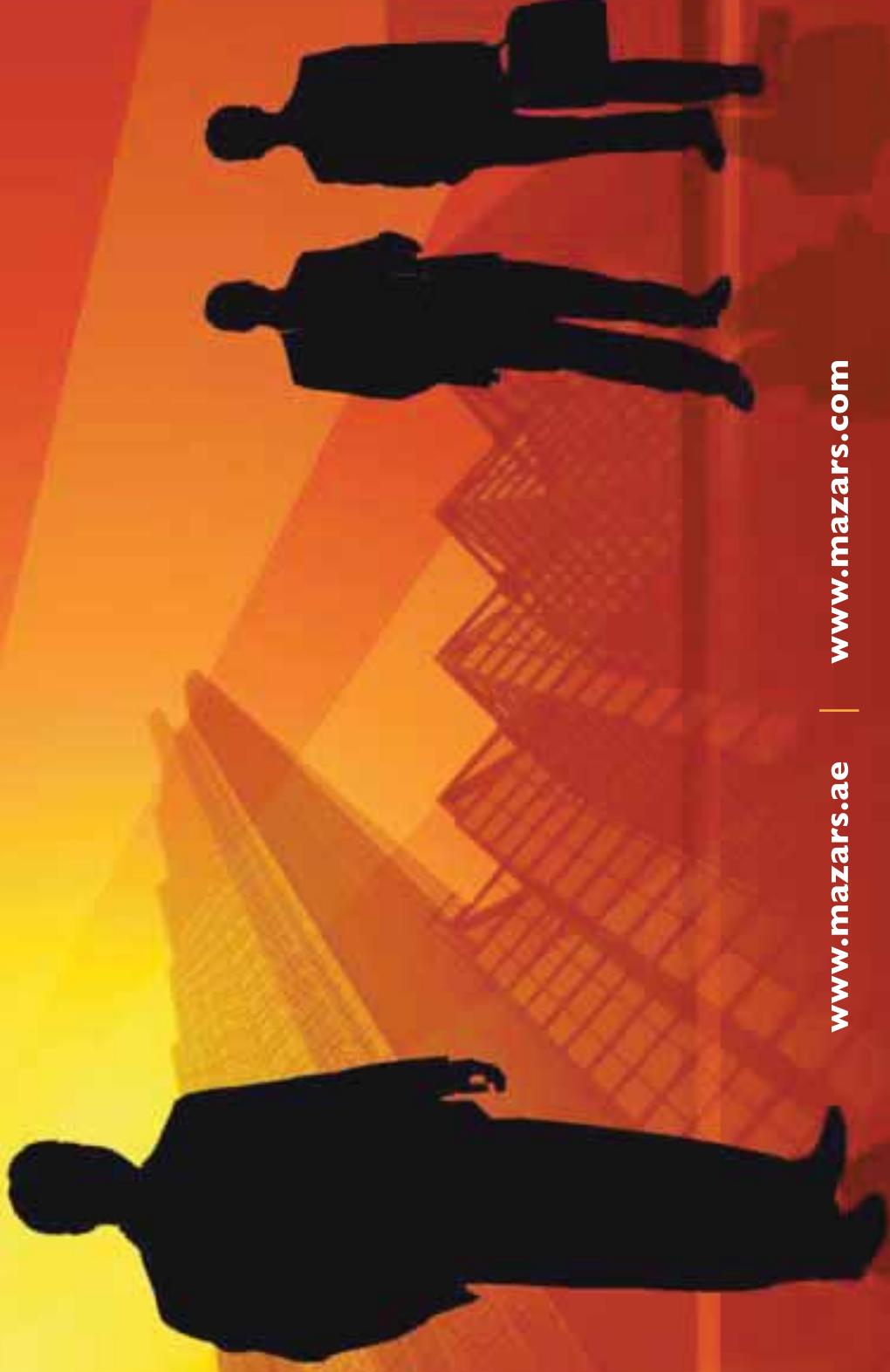
Saudi Arabia

Kuwait

Jordan

Palestine

Lebanon



www.mazars.ae

www.mazars.com

MAZARS Middle East LLP

PO Box 6212, Dubai - UAE

Tel: +971 4 3573111

Fax: +971 4 3573110

Email: contact@mazars.ae

When you partner with CCC
you get

excellence
commitment
and a
human touch

CCC is your Global Partner
in the Engineering and Construction Industry

We Simply Deliver



Consolidated Contractors Company
www.ccc.gr